

Political Participation of Private Entrepreneurs in China

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Abstract

This thesis empirically examines the determinants of the entrepreneur's political participation by employing a unique matched firm-institution dataset from China. Due to the underdevelopment of markets and market-supporting institutions in transition countries, entrepreneurs may rely on alternative institutions to do business. Besides going underground, relational contracting and government ownership of firms in response to this state/market failure, political participation of private entrepreneurs in China presents another kind of entrepreneurial response that helps overcome the lack of well-functioning markets and market-supporting institutions. Our empirical analysis shows that the likelihood of an entrepreneur's participation can be explained by the underdevelopment of the market and imperfections in market-supporting institutions. Our findings support the view that the institutional environment shapes the private entrepreneur's motivation to participate in politics; they also provide another example of how private entrepreneurs respond to state/market failure in transition economies.

摘要

本文通過對一個公司與制度環境相匹配的中國數據的實證分析，對企業家參政行為的決定因素進行了研究。由於市場的不成熟以及市場配套制度的缺失，企業家會依靠其他替代性制度展開商業活動。除了參與地下經濟，關係性契約以及政府所有制，在中國，私營企業家參政也是一種可行的解決市場/政府失靈的方法。實證分析表明，各地市場及其配套制度的發育程度可以用來解釋企業家參政的可能性。這個發現支持了制度環境對私營企業家的參政動機有重大影響這一觀點。我們的研究也為企業家如何對轉型國家市場/政府失靈作出反應提供了一個新的例子。

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1 Introduction

The underdevelopment of markets and market-supporting institutions is a common feature of transition economies. Governments in these countries normally possess considerable control over the allocation of resources either through their residual power of planning or through their control of state-owned enterprises, including banks (Nee, 1992; McMillan, 1997). Because of the high degree of control exercised by these governments and the imperfections in the product and credit markets, private businesses cannot fully rely on the markets to secure resources. The same governments may also intervene in private business by frequently imposing unnecessary regulations (red tape) and/or very high tax rates (Johnson et al. 2000; Guriev, 2004). According to De Soto (1989) and Brunetti et al. (1997), these regulations and taxes have come to impose considerable costs on private firms in transition economies. Apart from the weaknesses in state and market institutions, the legal systems in these countries are also very weak (Hay and Shleifer, 1998). Because laws are either non-existent or are not enforceable, entrepreneurs cannot rely on the legal system to secure property rights and to enforce contracts (McMillan and Woodruff, 1999a; Frye and Zhuravskaia, 2000).

Because of the lack of market-supporting institutions, private entrepreneurs in these countries have to rely on other institutions to do business. Entrepreneurs in Eastern Europe and Russia have been observed to go underground to escape over-regulation and high taxes (Johnson et al., 1997 and 1998; Friedman et al., 2000). In Vietnam, the courts are incompetent, and entrepreneurs there depend heavily on relational contracting in order to lower their contract enforcement costs (McMillan and Woodruff, 1999a and 1999b). In China, to overcome these institutional difficulties, local governments themselves became involved in business operations, and this led in the 1980s to the creation of an exceptionally innovative government ownership form known as the Township-Village Enterprises (TVEs).¹

Another response to state and market failures, one which has been much overlooked in the literature, occurs where entrepreneurs actively participate in politics to overcome the lack of well-functioning markets and market-supporting institutions. Or, to put it the other

¹See, eg. Chang and Wang (1994), Li (1996), Che and Qian (1998) and Jin and Qian (1998) for the literature on TVEs.

way round, entrepreneurs' motivation to participate in politics is shaped by the institutional environment in which they operate (Bartels and Brady, 2003). Many entrepreneurs in Russia, to defend themselves against "legislation that could raise their taxes, tie them to red tape, or threaten their property rights," are vying to secure a seat in the Duma, the popularly elected lower house of Russia's legislature. Dmitry Orlov, a political scientist at the Independent Center for Political Technologies in Moscow, estimates that one fifth of the Duma's 450 seats are going to be directly occupied by business people, and twice as many as that (about 180 positions) could go to business lobbyists representing their clients' interests (*Business Week*, Dec 8, 2003). Likewise, an increasing number of businessmen in Vietnam are running for the National Assembly, the country's highest legislative body (*Far Eastern Economic Review*, May 9, 2002). The issues commonly taken up by these entrepreneurs include cutting the heavy tax burden and making it easier to start private businesses. Recently, more and more members of China's business elite have begun actively participating in politics. Many of them have attained membership of the People's Congress (PC) or the Chinese People's Political Consultative Conference (CPPCC). Membership of the PC or CPPCC is advantageous to private entrepreneurs not only because it gives them some measure of political power, but also because it makes it easier for them to cultivate formal and informal ties with important government bureaucrats who are also members of the two organizations. Chinese private entrepreneurs who are PC or CPPCC members can obtain resources which are not accessible through markets; they can circumvent government regulations; they can secure tax deductions and obtain legal or non-legal protection for their businesses.²

In this thesis, we examine the determinants of the entrepreneurs' political participation by employing a unique matched firm-institution dataset from China. We hypothesize that a private entrepreneur is more likely to participate in politics if his/her firm is situated in a province where market-supporting institutions are weaker. Employing the multinomial logit model, we find that a private entrepreneur is more likely to participate in politics where the market is less developed, where the local government has more regulations, where

²Likewise, in the United States, individuals and interest groups make political campaign contributions in anticipation of receiving future "services" in return, which include tax exemptions, alleviation of regulatory burdens, etc. See Snyder (1990) for a review of the relevant literature.

the informal tax burden is heavier, and where the legal system is weaker. This empirical finding supports our conjecture that the institutional background shapes the entrepreneurs' motivation to participate in politics. We also find that both the human and political capital of entrepreneurs contribute positively to the likelihood of their political participation.

To the best of our knowledge, this is the first empirical study of the political participatory behavior of private entrepreneurs in transition countries.³ Unlike other institutional responses such as going underground and government ownership, political participation is an aggressive response of entrepreneurs to state, market and legal failures in transition countries. By participating in politics, private entrepreneurs as a whole will have a profound impact on the development and implementation of policies and laws in transition countries.

The structure of the thesis is as follows. Section 2 introduces the institutional background in China. Section 3 proposes several hypotheses pertaining to the determinants of political participation. Section 4 describes the data and variables. Section 5 outlines the econometric specification. Section 6 empirically tests the hypotheses and reports results. Section 7 concludes.

2 Institutional Background

In this section, we first describe the history of private business in China since its rebirth in 1978 when the far-reaching economic reform started. In particular, we focus on the institutional environments in which firms have grown in the past two and a half decades. We then outline the basic characteristics of the two political bodies in which private entrepreneurs have been actively participating, i.e., the People's Congress and the Chinese People's Political Consultative Conference.

2.1 Private Businesses in China since 1978

Private business regained its legitimacy in 1978, when the state endorsed the re-emergence of individual household business during the Third Plenum of the Communist Party's Eleventh

³Morduch and Sicular (2000) study whether being a party member or a cadre increases a farmer's personal income, but they do not study political participation itself.

Central Committee.⁴ Despite ideological and other obstacles, from 1978 to 2001, China's private businesses grew from zero to over 38 million firms employing 160 million people and producing more than one third of China's industrial output. The growth rate of the private sector has far outpaced that of the public sector since its revival.

In spite of the speed with which the private sector developed after 1978, the path was by no means free of obstructions.⁵ Although private businesses were accorded a measure of political recognition when they resurfaced in 1978,⁶ they were not allowed to hire more than eight employees. This rule remained in place until ten years later, when the National People's Congress authorized the establishment of private enterprises with more than eight employees.⁷ In the 15 years following the beginning of the reform, private firms were considered an inferior ownership form for ideological reasons. Despite the existence of formal legislation permitting it, the overall political environment was antagonistic towards private business in the early years of reform (Young, 1989). Private entrepreneurs had to deal with hostility and social prejudice on the part of cadres and people in general who regarded them as dubious, ignoble, or even despicable. Challenges to the legitimacy of private business also came in the form of various political movements, e.g., periodic campaigns against spiritual pollution in 1983-1984, against bourgeois liberalization in 1987, and other movements cracking down on private businesses on the plea of "rectifying the market" and "attacking speculation," to name a few. Until the early 1990s, private entrepreneurs were carefully controlled and denied entrance into the political establishment.

Ideology has become less important since the early 1990s. At the Fourteenth Party Congress held in 1992, the government attempted to raise the image of the private sector by discarding ownership discrimination and acknowledging the important role played by the private sector in China's social and economic development. This was followed by the

⁴When the Communist Party won the civil war and founded the People's Republic of China in 1949, it began the socialist transformation of private businesses. Between 1952 and 1977, private businesses were completely banned in China.

⁵See Young (1995) for a comprehensive description of the development of the private sector in China since 1978.

⁶They were presented as peripheral in the Constitution of 1978, considered "a marginal sector to be tolerated temporarily and tightly controlled" (Young, 1995; pp. 14).

⁷An edict titled "Provisional Regulations of the People's Republic of China on Private Enterprises" was issued in June 1988. See the People's Daily (*Renmin Ribao*), June 29, 1988.

lifting of various restrictions on private business (Sabin, 1994). Indeed, even before this formal endorsement of the private economy, four private business owners from Shenzhen, the city from which most of China's reforms started, became members of the Chinese People's Political Consultative Conference at the national and local levels, and another two became members of the local People's Congress in 1991,⁸ symbolizing the loosening of the ideological concerns that had dogged private sector development throughout the 1980s.

However, the economic environment in China remains far from perfect for private businesses. The official document from the same party congress also stated that the government should create fair market conditions, under which firms characterized by different types of ownership structures can compete fairly with each other. However, there is still a long way to go before the market environment in China becomes truly fair for private firms. The government still controls much of the resources; the state owned enterprises enjoy preferential status in obtaining bank loans and in other key inputs (Che, 2002; Brandt and Li, 2003); private businesses are subject to arbitrary harassment by government officials (Pearson, 1997); and commercial and property laws are either non-existent or are not enforceable (McMillan, 1995).

Given the adverse political and economic environment and the discrimination suffered by the private sector, private entrepreneurs have been finding new ways to make their operation easier. In the early 1990s, many private businesses chose the somewhat expedient strategy of "wearing a red hat", that is, they registered themselves as "collective enterprises" (Pearson, 1997; Che and Qian, 1998; Gore, 1998).⁹ The disguise of "collective ownership" not only made these firms ideologically acceptable, it also won them material advantages like favorable tax treatment and better access to credit and other resources (Nee, 1992; Naughton, 1994). Since the loosening of ideological and political constraints in the 1990s, many of these private entrepreneurs have sought a new and even more powerful "red hat", i.e., they have been choosing to actively participate in politics. In particular, more and

⁸See Pearson (1997), pp.111. A further twenty-one entrepreneurs were chosen to attend the March 1993 meeting of the Chinese People's Political Consultative Conference ("Private business to play a bigger role", *China Daily*, Oct 21, 1992).

⁹Also see Garnaut et al. (2001), pp. 46, Box 4.1 for an example.

more entrepreneurs are becoming members of the two powerful political bodies, the People's Congress (PC) and the Chinese People's Political Consultative Conference (CPPCC). We introduce these next.

2.2 PC and CPPCC

The People's Congress is China's legislature, which, as stipulated by the Chinese Constitution, is the highest organ of state power in China. Following the party and government hierarchies, there is a PC at each administrative level, including the central, provincial, municipal, county and township levels. Local PCs have the power to elect chief officials at their own administrative levels, to draft and approve local laws and policies, and to impeach government officials when necessary. The PC at the central level, or the National People's Congress (NPC), is considered the highest organ of state power of the People's Republic of China. Its main functions and powers include making laws and policies and electing top government officials in the central government. Theoretically, the PCs at all levels are instituted through elections, but the party and government officials still control the process of candidate nomination. Thus, it is not surprising that all major party and government officials are deputies of the PC at the local/central level.

The Chinese People's Political Consultative Conference is an advisory body to the party/government in China, somewhat analogous to an advisory legislative upper house. The main functions of the CPPCC are to hold political consultations and to exercise democratic supervision of the party and governments. Political consultation is held on major political, economic, cultural and social policies, both before decisions are made and in the process of their implementation. By making proposals and criticisms at regular meetings with the party and government officials, the CPPCC exercises its function of democratic supervision over the enforcement of China's Constitution, laws and regulations, the implementation of the major policies and the performance of government departments and their employees. When a CPPCC member makes a proposal, the government is committed to responding to it within a certain time.¹⁰

¹⁰For example, a private firm owner and also a member of the CPPCC Zhejiang Provincial Committee in 1996 successfully introduced proposals for simplifying the authorization procedures for private projects,

Although the party/government still has tight control over the CPPCC, it is more independent from the party/government than is the PC. Although CPPCC nominees on the preliminary list need to survive the screening process by the party to get on the final slate, all social and economic organizations are allowed to nominate their own candidates. Because of the special mechanism for selecting CPPCC members, it has a much smaller party representation than the PC and its members come from more diversified backgrounds, many of them being members of the social, cultural, and business elite. The average education level of CPPCC members is much higher than that of PC members.

3 Hypotheses

Before discussing hypotheses, we first define private entrepreneurs and political participation. In this thesis, we refer to owners of private firms as private entrepreneurs. We refer to the securing of membership in the PC/CPPCC as political participation.

In this section, we begin by describing four major institutional difficulties faced by private businesses in transition countries. We then summarize several responses with which private businesses seek to deal with these difficulties. These responses have been well studied in the literature. Finally, and more importantly, we argue that political participation of private entrepreneurs can serve as an institutional response that overcomes these difficulties. Based on these arguments, we develop hypotheses regarding the determinants of political participation of private entrepreneurs in China.

Transition countries are characterized by posing several institutional difficulties for private businesses. Firstly, one of the most important difficulties is market failure, especially in the early stage of transition (McMillan, 1997). The governments in these countries usually possess monopolistic control over input and product markets (Chang and Wang, 1994). Many key resources such as power and raw materials are monopolized by state-owned enterprises, making them very difficult for private firms to obtain (Li, 1996). Another key input, credit, is also tightly controlled by state-owned banks, which private firms find it hard to access

appeals for non-discriminatory treatment in extending credit, and legal protection of the property rights of private businesses (Heberer, 2003, pp. 218).

(Brandt and Li, 2003). Even when the markets become more developed as the transition process evolves, market failure may still substantially affect private businesses.

Secondly, excessive regulatory burdens, known as red tape, have been widely observed in transition economies (De Soto, 1989; Brunetti et al., 1997; Guriev, 2004). The various forms of red tape imposed on entrepreneurs include unnecessary official routines, complex rules, and extended procedures that result in delays. Self-interested bureaucrats usually have discretion over the nature and amount of harassment meted out to private businesses, and they can use this power to extort bribes. Many government offices have the power to fine a firm or even terminate its production. For example, a fire inspector or a sanitary inspector can go to a firm to pick up on problems from time to time.¹¹ Business activities in China have been notoriously hampered by the stringent system of “Administrative Examination and Approval.” Anecdotes abound about private start-ups taking years to get through the lengthy procedures required to obtain a business license or permit.¹² Firms waste considerable amounts of management time and resources steering through the bureaucracy. These pecuniary and non-pecuniary costs borne by firms present a major hindrance to business practice.

Thirdly, heavy formal and informal tax is another feature of transition. Johnson et al. (2000) find that in Russia and Ukraine, the effective tax rates reported by respondents in their survey are formidably high. Government officials in these countries have been depicted as grabbing hands, preying on private businesses (Frye and Shleifer, 1997; Shleifer, 1997; Gelb et al., 1998; Levin and Satarov, 2000). Although the formal tax rate is uniform across localities in China, informal taxes and fees differ dramatically across localities (Wong, 1998). To fulfill the fiscal revenue target, to maintain public facilities and to pay their own wages, local government officials in China engage in fee collection and fund-raising activities of

¹¹It was reported by Xinhua News Agency on September 8, 2002 that in Hengyang, Hunan Province, a drink producing firm was on the verge of shutdown only within half a month of its opening. The major cause was that several regulatory agencies inspected the firm for no reason. Because the entrepreneur refused to pay some “relational fees” he had a heavy fine imposed on him. Later, officials withheld his production certificates and even held him in custody.

¹²For example, in Jinhua County of Zhejiang Province, a farmer wanted to set up a chicken farm. He spent two years running from one office to the other and collected over 270 official stamps. When he was finally given a business licence, the optimal time for his planned investment had already passed (People’s Daily (*Renmin Ribao*), August 28, 2003).

various names as a complement to formal taxes. A large portion of these fees, charges and fund-raising methods are erratic, and in many cases unauthorized or even illegal (Fan, 1998).

Finally, transition countries also lack a sound legal system, which is critical for property rights protection and contract enforcement (McMillan and Woodruff, 1999a ; Johnson et al., 2002). In China's case, the pace of legal reform lags far behind its economic reform (Clarke, 1996). Basically, the transition took place in an environment lacking the rule of law to prevent the government from encroaching on private enterprises (Che and Qian, 1998). The legal framework also plays only a limited role in contract enforcement, where bureaucrats adjudicate most disputes (Walder, 1995).¹³

In response to these state and market failures, firms in transition countries have been relying on other institutions to support their operations. It has been documented that firms in Russia, Ukraine and Eastern European countries choose to take their operations underground to elude high taxes and the "grabbing hand" of the government, and to escape from excessive bureaucracy (Johnson et al., 1997 and 2000; Friedman et al., 2000). Several empirical works provide cross-country evidence that the size of the unofficial economy is positively correlated with measures of over-regulation and heavy taxes (Johnson et al, 1998; Friedman et al, 2000).

Firms may also rely on ad hoc substitutes for the missing formal institutions. In particular, firms may build their own institutions, also known as "self-help" (McMillan and Woodruff, 2002). For example, in the absence of laws for the enforcement of contracts, firms in Vietnam rely heavily on inter-firm relationships to make deals. Also in Vietnam, firms depend on informal credits from suppliers when they have limited access to formal financial markets (McMillan and Woodruff, 1999a). In Russia, private mechanisms such as arbitration are used instead of courts to resolve disputes (Hay and Shleifer, 1998). Firms may also pay mafias for private protection. Frye and Zhuravskaya (2000) and Sonin (2003) find that weak legal institutions drive private businesses to hire racketeers as private suppliers of protection.

In response to the lack of market-supporting institutions, Chinese local governments

¹³As such, private firms usually face unfavorable treatment when they engage in disputes with State Owned Enterprises, which are part of the political hierarchy and have close ties with the government (Bai et al., 2003).

themselves become involved in business operations. In the 1980's, township-village enterprises (TVEs) flourished as a highly distinctive form of local government ownership. Previous studies on Chinese TVEs have shown that local governments have been instrumental in the success of these non-state firms by providing them with crucial inputs, such as land and credit where factor markets were underdeveloped and prices of inputs were tightly controlled (Chang and Wang, 1994; Naughton, 1994; Putterman, 1997; Che and Qian, 1998). Nee (1992) contends that local governments contribute substantially to the growth of TVEs by utilizing political ties to expand these firms' market reach. Local government ownership also protects TVEs from being interfered with by government at higher levels (Che and Qian, 1998). Jin and Qian (1998) find empirical evidence that the development of TVEs in a locality is negatively correlated with its market development.

Entrepreneurs may also actively participate in politics to reduce the costs associated with market, state and legal failures. In this thesis, we argue that rather than operating unofficially or establishing self-help among peers, many competent Chinese entrepreneurs make a very different choice, namely, to participate in politics to overcome the lack of formal institutions to support their business operations. More specifically, entrepreneurs may participate in politics by obtaining membership of the PC or CPPCC.

Membership in the PC or CPPCC helps to overcome state/market failures. In areas where markets are underdeveloped, private firms cannot completely count on the market mechanism to do business. As with the distinctive ownership form of TVEs, support from the government or government officials can also be valuable to private entrepreneurs. Since entrepreneurs in the PC/CPPCC have many opportunities to interact with government officials, and since government officials for their part also need political support from the political bodies, a PC/CPPCC membership can make it easy for entrepreneurs to cultivate a close relationship with government officials. These privileged entrepreneurs may well draw on such ties to facilitate their business operation. In areas where state economies dominate, membership may reduce ideological discrimination from government or other regulatory agencies. Being friends of officials and having some political power themselves, PC/CPPCC mem-

bers can effectively shield themselves against state encroachment when local governments act as “grabbing hand.”¹⁴ PC/CPPCC members may also enjoy other forms of preferential treatment from governmental agencies that would not be possible for other private firms.¹⁵ Finally, certain political arrangements in the polity may lower the cost of settlement of disputes where legal instruments are inadequate or law enforcement is weak. The reputation effect also benefits these entrepreneurs in making and enforcing contracts. The above arguments lead to Hypothesis 1.

Hypothesis 1: *Private entrepreneurs whose firms are located in provinces with weaker markets or market-supporting institutions are more likely to engage in political participation. Specifically, political participation is more likely, when the market is less developed, when the local government has more regulation, when the informal tax burden is heavier, and when the legal system is weaker.*

Political participation is not without cost. The most important cost is time. According to the law, PC members are required to attend at least the annual meeting lasting two to ten days, and they have to attend many other ad hoc meetings. Moreover, PC members in some localities have to participate in the activities organized by the local PC for at least 15 days a year.¹⁶ These meetings impose a huge time cost on the already very busy entrepreneurs. Although political campaigns are prohibited in China, some entrepreneurs lobby for candidacy or membership in the PC/CPPCC, and this also involves time and pecuniary costs.¹⁷ These costs notwithstanding, entrepreneurs may still choose to participate in the PC and CPPCC because the costs are outweighed by the much larger benefits, especially in places

¹⁴According to an article in the China News Week (*Zhongguo Xinwen Zhoukan*, No.9, 2001), regulatory agencies are afraid of overcharging PC/CPPCC members because they could raise issues of overcharging to higher level government officials at regular meetings.

¹⁵For instance, as reported by Xinhua News Agency on August 21, 2001, a private decoration firm owner in Yuncheng City, Shanxi Province claimed that it would be easier for him to take projects in this city if he had been elected to the People’s Congress at the municipal level.

¹⁶See Newsletters of Hainan People’s Congress (*Hainan Renda*), Issue 8, 2001.

¹⁷In a handful of extreme cases, private entrepreneurs bribe government officials and constituents in order to be elected as members of the PC. For example, in Linfen City, Shanxi Province, several private entrepreneurs were found to have paid bribes to be elected to the People’s Congress at the municipal level (China News Week (*Zhongguo Xinwen Zhoukan*), No.9, 2001).

where market-supporting institutions are weak.

Along with the external institutional environment, the characteristics of the entrepreneurs and their firms are also important determinants of their political participation behavior. In this thesis, we focus on two sets of characteristics, i.e., those representing their political capital and those representing their human capital.

Entrepreneurs may develop their political capital through their interactions with the party and government. The Communist Party of China still maintains a very strong influence over the legislature, largely by being able to recommend candidates, to control the extensive screening process, and even to determine the membership of the PCs at various levels. In selecting the PC members, political reliability (conformity) and personal relationship play a very important role. Party members and managers of former public firms (State Owned Enterprises or Township-Village Enterprises) have a natural advantage in terms of their perceived reliability. They have already established their position in the bureaucratic system, because only politically reliable people can join the party or become public firm managers. Party members and former public firm managers may also have cultivated personal relationships through their numerous interactions with the party/government leaders. They also have an information advantage, having developed formal and informal communication channels with party/government officials and because officials know their qualifications better than those of other entrepreneurs. Thus we expect that entrepreneurs who are party members or/and former public firm managers are more likely to attain membership of the People's Congress at various levels. However, being a party member or a former public firm manager may not be sufficient to secure membership in the CPPCC, over which the party has less control.

Political capital may also be correlated with firm size and history. Large firm size can usually be translated into more resources, greater control over labor, stronger economic impact on the local community and therefore more bargaining power with the state (Hellman et al., 2003). Thus we expect that large firm size potentially contributes to the political success of the firm's owner. Managers can also wield greater influence if their firms have operated

in the locality for a longer period, since close ties with the state cannot be cultivated within a short timescale. To summarize, we state the second hypothesis as follows.

Hypothesis 2: *An entrepreneur's likelihood of political participation increases with his/her political capital. In particular, it is more likely when the entrepreneur is a party member and/or a former public firm manager, and when the firm is larger and/or has a longer history.*

Finally, the entrepreneur's political participation behavior may also depend on his/her human capital. We expect that general human capital variables such as age, schooling and birth place contribute to the likelihood of political participation. This is summarized as our third hypothesis.

Hypothesis 3: *The entrepreneur's political participatory behavior depends positively on his/her human capital.*

4 Data and Variables

The data used in this study come from two sources: the nation-wide survey of privately-owned enterprises and the provincial-level institutional indices. The survey of privately-owned enterprises was conducted jointly by the All China Industry and Commerce Federation, the China Society of Private Economy at the Chinese Academy of Social Sciences, and the United Front Work Department of the Central Committee, the Communist Party of China in 2002. The sample contains mainly large firms with a small portion of individual household businesses drawn from 31 provinces covering all political subdivisions at this level in Mainland China,¹⁸ and therefore generate enough variation in local institutional settings. This feature allows us to investigate how Chinese entrepreneurs respond to the institutional heterogeneity across provinces, especially in their political participatory behaviors.

The dataset is by far the best one for studying the political participation of private

¹⁸The average size of our sample is 169.4 employees, which is much larger than the national average of 11.4 (YICAC, 2003).

business owners in China. In total, we have 3,258 privately owned enterprises and individual household businesses, representing 0.16 percent of the total privately-owned firms and businesses nationwide. The survey involves an intensive interview of the firm owner, with questions covering many aspects of the firm including the firm's size, history and basic financial information, as well as the firm owner's family background, human capital and occupational history.¹⁹ Most importantly, the survey contains information on the owners' political participatory behavior, such as membership of the party and the PC or CPPCC.

A primary analysis of the data shows that private business owners actively participate in politics (Table 1). Out of the 3,258 business owners, 17 percent possess membership in the PC at various levels, and 35 percent are members of the CPPCC.²⁰ Moreover, about 30 percent of the entrepreneurs are party members and, not surprisingly, most of these joined the Party before they started their own businesses.

In our dataset, the firm owners' work experience is reported in great detail. On average, the entrepreneurs in our data have more than 10 years' management experience (Table 1). More than one third are former employees in state-owned or collective enterprises. The firms in our sample come from diversified industrial sectors, from farming to technical services. Their sizes range from individual household businesses to large scale enterprises with up to 4,000 employees.²¹

In addition to the firm survey data, we also make use of the National Economic Research Institute (NERI) Index of Marketization (IM) of China's provinces in 2001 to measure the

¹⁹See Table A1 for a detailed description of variables.

²⁰Anecdotal evidence shows that the percentage of PC and CPPCC members among private entrepreneurs does not normally exceed 10 percent. For example, in 1996 in Fuyang City, Anhui Province, 6.6 percent of the private entrepreneurs were members of either the PC or CPPCC at various levels (Heberer, 2003; pp. 217). The percentage in our sample is high because the firms are, on average, 14 times larger than the average firm size in the country as a whole and, as we will show in the empirical work, the likelihood of political participation increases with firm size. For instance, at least 63 percent of the Forbes richest 100 Chinese entrepreneurs, who are owners of the largest private firms in China, are PC/CPPCC members at the central or provincial levels.

²¹Additional attention should be paid to the employment variable. We use employment, or the number of persons employed, to measure a firm's size. One difficulty is that some labor contracts are effective for only one year or even less. Some temporary employees do not have formal contracts. Thus we measure the employment of a firm with a weighted average of workers or staff with different employment durations. Workers employed all year round are given full weight, namely one. Employees hired for less than one year but more than 6 months have a weighting of 0.5. Those employed for less than 6 months have a weighting of 0.25.

quality of market-supporting institutions at the provincial level.²² The NERI indices capture the progress of institutional transition in China's 30 provinces (excluding Tibet, due to the lack of data). Appraisals of the regional institutions are made in several dimensions, namely the relationship between the government and the market, the development of the non-state sector, the development of the markets, the development of market intermediaries and the legal environment. See Appendix 1 and Table A2 for a detailed description of all indices.

To test Hypothesis 1, we use several indices of marketization to measure institutional heterogeneity across regions. First, we use a sub-index which scores the percentage of commodity prices determined by the market mechanism. The higher this ratio, the more market-oriented is the allocation mechanism in the province. The development of the financial market is measured by the percentage of deposits taken by non-state financial institutions and the percentage of short-term loans to the non-state sector. Second, we make use of the index named "the government's excessive administrative intervention in enterprises" as a proxy for the intensity of over-regulation in a province. In surveys commissioned by the Chinese Entrepreneurs Survey System, enterprise managers were asked to rank the relative importance of interactions with governments and other public agencies in their routine work. The index draws on this data to compute the provincial level of bureaucratic red tape, for which a lower score implies more over-regulation. Third, to measure the relative severity of government predation, we draw on a sub-index named "enterprises' extra-tax financial burdens." It is calculated based on the enterprises' financial burdens other than on official taxes as a percentage of sales from the Survey System. Finally, we apply the sub-index corresponding to the number of lawyers as a percentage of the population in a province as a measure of the legal environment. A higher ratio usually implies a higher faith in the rule of law and therefore more extensive use of legal instruments in dispute resolution.

The aforementioned data sources contain three sets of independent variables that we use in our empirical analysis, namely the human capital, political capital and institutional indices. The human capital measures include the entrepreneur's age, education, years of

²²The NERI Index project was sponsored by the National Economic Research Institute and the China Reform Foundation and conducted by Fan et al. (2003).

management experience and whether he/she has a rural origin. The political capital measures include variables indicating whether the entrepreneur is a party member and/or a former public firm manager, and the firm's age and total employment. Finally, we use a set of institutional indices to measure the development of product and credit market, government regulations, the informal tax burden and the legal system, with larger values of these indexes indicating better institutions.

5 Econometric Specification

Our objective in this study is to examine the underlying determinants of private entrepreneurs' political participation behavior. Since there is no natural ordering of the participation choices (namely, PC, CPPCC and neither), we apply the multinomial logit model to estimate the likelihood of private entrepreneurs' political participation.

The multinomial logit model is specified as follows. Let p_{ij} be the probability of entrepreneur i choosing option j , where j equals 0 if i does not participate in politics, equals 1 if i is a member of the PC and equals 2 if i is a member of the CPPCC. Let x_i denote variables measuring the quality of institutional environments, and the entrepreneur's political and human capital. The probability p_{ij} is then given as:

$$p_{i0} = \frac{1}{1 + \sum_{k=1}^2 e^{\beta'_k x_i}}$$

$$p_{ij} = \frac{e^{\beta'_j x_i}}{1 + \sum_{k=1}^2 e^{\beta'_k x_i}} \quad \text{for } j = 1, 2$$

Here, the group of entrepreneurs that are neither PC nor CPPCC members (the non-participation group) are chosen as the base category for comparison.

Using the non-participants as the base group, we derive the the log-odd ratios,²³ defined as

$$\ln \left[\frac{p_{ij}}{p_{i0}} \right] = \beta'_j x_i \quad \text{for } j = 1, 2$$

²³Odds ratio is also known as the relative risk ratio. The odds ratio measures how likely participation in the PC or CPPCC is relative to the base category, i.e., non-participation. In the multinomial logit model, the log of odds ratio is a linear function of the independent variables.

Thus, we will report the estimated coefficients, i.e., β_j , which affect the log-odd ratios in a linear way.

6 Empirical Results

This section systematically tests our hypotheses using the data described above. We apply a simple conditional probability analysis followed by the formal analysis using the multinomial logit model.

6.1 Conditional Probability Analysis of Political Participation

Before the regression analysis, we first use a conditional probability analysis to examine the correlation between the likelihood of political participation and the potential determinants. For now, we do not distinguish between membership in the PC and membership in the CPPCC, and only examine how the probability of political participation (in either the PC or CPPCC) varies with these potential determinants.

Table 2 shows that the probability of political participation rises with the general human capital and political capital variables. Participation is more likely when entrepreneurs are older (0.40 vs. 0.53) and more experienced (0.39 vs. 0.55). However, entrepreneurs with more education have almost no advantage in political participation (0.46 vs. 0.47). Moreover, party members are more likely to participate in the PC/CPPCC (0.46 vs. 0.55). Similarly, previous work experience as a public firm manager also raises the probability of political participation from 0.45 to 0.54. Further, an entrepreneur is more likely to participate if his/her firm has a longer history (0.39 vs. 0.54) or a larger size (0.35 vs. 0.58).

More importantly, political participation is more likely for entrepreneurs doing business in a province where markets or market-supporting institutions are less developed. The underdevelopment of product markets raises the probability of participation from 0.43 to 0.53, whereas the underdevelopment of the credit markets raises the probability from 0.43 to 0.56. Table 2 also shows that entrepreneurs in a province where local governments have more regulations are more likely to participate in politics (0.43 vs. 0.58). Correspondingly, those in a province where the legal system is weaker are more likely to participate (0.44 vs. 0.55).

However, a higher level of informal tax burden alone does not increase an entrepreneur's likelihood of political participation.

In general, this simple tabulation shows that the political capital, human capital and institutional indices are indeed correlated with political participation as expected. However, we do not know whether these associations are statistically significant. Neither do we know whether participation in the PC differs from participation in the CPPCC in terms of its associations with these variables. We therefore turn to the formal regression analysis.

6.2 Multinomial Logit Analysis of Political Participation

We start the analysis with a baseline regression, which tests only Hypothesis 3, or the effect of human capital variables such as the entrepreneur's age, education, years of management experience, and whether he has a rural origin as independent variables. We then add the political capital and institutional variables into the analysis. In all regressions, we control for plausible heterogeneity across industries using a set of industrial indicators.

Our baseline analysis shows that human capital indeed matters for political participation of entrepreneurs, but its role differs for PC membership as compared with CPPCC membership (model (1) of Table 3). The coefficients pertaining to the firm owner's human capital are all positive and significant at least at the five percent level. An entrepreneur who is older, more educated, and with more management experience is more likely to be a member of either the PC or the CPPCC. These findings suggest that both political organizations emphasize good human capital in selecting their members. Comparing the coefficients on education in the two columns, we find that education plays a more important role in CPPCC membership than in PC membership, the former having a coefficient almost double that of the latter, which again shows that the CPPCC places more emphasis on the education level of its members. The results also show that entrepreneurs with a rural origin have a higher likelihood of participating in the PC but not in CPPCC, probably reflecting the fact that the PC more evenly represents the population, the majority of which are from rural areas.

In model (2) of Table 3, we add personal political capital variables, i.e., party membership and public firm management experience as independent variables. The regression shows

that party members and former public managers are more likely to be members of the PC, but may not have an advantage in obtaining membership of the CPPCC. The party member and former public firm manager dummies have positive coefficients in both columns 3 and 4, but they are significant only for PC membership. Moreover, with these new independent variables added, coefficients of human capital variables attenuate in column 3. The education variable even becomes less significant in contributing to the likelihood of PC membership, which confirms our earlier conjecture that the PC cares less about the education level of its members.

In model (3) of Table 3, we include the firm's attributes, namely the firm's age and employment (in natural logarithm), as independent variables. The regression shows that owners of older firms are more likely to participate in politics, since the coefficients of firm age are significant at the five percent level in both columns. The regression also shows that owners of larger firms are more likely to be members of the PC or CPPCC. The coefficients measuring the firm's size are significant at the one percent level in both columns of model (3). An increase in a firm's size by one percent will increase the odds ratio of being a PC member relative to non-participation by 0.58, and increase the odds ratio of being a CPPCC member relative to non-participation by 0.33.

In general, the regressions in Table 3 show that the likelihood of political participation increases with the entrepreneurs' political and human capital. However, some of these variables differ in their effects on PC as against CPPCC membership. While education is important in determining the likelihood of being a CPPCC member, it has no effect on the likelihood of being in the PC. By contrast, being a party member or former public firm manager only helps an entrepreneur in obtaining membership of the PC, not of the CPPCC.

We next test the main hypothesis, Hypothesis 1, i.e., political participation is shaped by the institutional environments in which entrepreneurs operate their businesses. Regression results indeed show that entrepreneurs are more likely to participate in politics when the institutional environments they are situated in are more hostile.

In models (4)-(6) in Table 4, we test whether the development of markets has an ef-

fect on political participation. The results show that private entrepreneurs are more likely to participate in politics when the market, especially the credit market, is more underdeveloped. To avoid multicollinearity, we first employ one market index at a time, i.e., the product market and the credit market respectively in models (4) and (5) in examining the entrepreneurs' response to the development of different markets. The coefficients pertaining to the market indices are all negative as we expected. The coefficients of the product market index are significant only regarding participation in the CPPCC, while the coefficients of the credit market index are significant for participation in both the CPPCC and PC. Moreover, the coefficients on the credit market index are overall larger than the product market index.

In model (6), we include both market indices. The results continue to show that the credit market plays a more important role in shaping the entrepreneur's political participation behavior. The coefficients on the credit market index are negative and significant at the one percent level in both columns. However, the coefficients on the product market indices turn positive, although insignificant. This is probably due to the high correlation between these market indices, suggesting that the product market has picked up some effects of the credit market in model (5). These results, together with the findings from models (4) and (5) provide some evidence showing that the underdevelopment of the credit market could be a more important reason for private entrepreneurs to participate in politics.

We interpret the different effects of the product market and credit market in the following ways. First, the product market is generally more developed and has a larger provincial variation than the credit market. The average development index for the product market is 7.88, versus 5.93 for that of the credit market, whereas the standard deviation of the product market index is smaller (1.70 vs. 2.02). These values show that, relative to the mean, the relative variation in the development of the credit market is much larger than that of the product market. The lower development level together with a larger variation means that the credit market is a more important explanatory variable. Second, the product market is more open and unified than the credit market in China. Since the 2002 sample does not contain information on the major market destinations of firms, we make use of the 2000

sample, which contains such information. Most (68 percent) of the firms in the 2000 sample sold their products to provinces other than the home province, and 34 percent exported. Considering the fact that many entrepreneurs do not confine their businesses within their home provinces, the development of the product market in their home provinces is not that important. On the other hand, firms normally get their credits from their home cities or provinces. In China, the credit markets are monopolized by four gigantic state-owned commercial banks, which have established branches at each administrative level. The locations of bank branches parallel the territory structure of the government system, and the scope of business is designed to minimize overlapping and competition within the same institution. Normally, bank branches are not allowed to lend beyond their own area. Thus, the credit-market is more province-specific for a firm, and is more important in affecting political participation.

We next test whether over-regulation, heavy tax burden, and weak legal environment also have an effect on political participation. Regression results reported in Table 5 show that most of these factors are important in shaping Chinese entrepreneurs' political participation behavior. Models (7)-(9) are three regressions, each of which has one of these three institutional indices. The coefficients on all three indices are negative. The coefficients on over-regulation and legal environment are significant at the one percent level, while those on tax burden are not significant. This provides some support to Hypothesis 1, which states that entrepreneurs in provinces with more regulatory burden and weaker legal enforcement are more likely to participate in politics. However, the effects of tax burdens are less significant, as regressions indicate.

In the last two columns in Table 5, we include all three institutional indices together with the credit market index, which is shown to be an important determinant. Even though including all indices may reduce their individual explaining power due to multicollinearity, the regression results continue to support Hypothesis 1. The credit market and legal environment indices are negative and significant at the one percent level. The magnitudes of the coefficients for these two indices are also similar to previous results. Over-regulation contin-

ues to have a negative effect on participation in the CPPCC, but not on participation in the PC. The coefficients of the tax burden measure remain negative and even become significant at the five percent level for the likelihood of being a CPPCC member as we control for other indices.

7 Conclusion

In this thesis, we employ a unique matched firm-institution dataset to test several hypotheses regarding the underlying determinants of political participation of private entrepreneurs in China. Our empirical work shows that the likelihood of an entrepreneur's participation can be explained by the underdevelopment of markets, especially the credit market, and imperfections of market-supporting institutions, including excessive government regulation, informal tax burdens and a weak legal system. Our findings support the view that the institutional environment shapes private entrepreneurs' motivation to participate in politics. We also find that the likelihood of an entrepreneur's participation is determined by both his/her human capital and political capital.

Our study provides another example of how private entrepreneurs respond to the imperfect markets and market-supporting institutions in transition countries. As with other responses such as hiding, self-help or government ownership, participating in politics can make entrepreneurs' own business operations easier. Unlike these responses, which are rather passive, political participation is apparently a more assertive response. By participating in politics, entrepreneurs as a group can have a far-reaching impact on the development of policy and law in these countries. Already, in China, their collective actions have led to some critical changes. Since 1998, private entrepreneurs have submitted numerous proposals to the NPC and CPPCC, requesting legal protection for private property rights.²⁴ Their endeavors finally led to the constitutional amendment in 2004, which for the first time since the foundation of the People's Republic of China in 1949 provides that the right to private property is inviolable (People's Daily (*Remin Ribao*) March 8, 2004).

As economic and political reforms evolve in China, private entrepreneurs will certainly

²⁴See Southern Weekend (*Nanfang Zhoumo*), March 18, 2004.

play a more important role in every aspect of the country. Recognizing this, the sixteenth National Congress of the Communist Party amended the Constitution of the party, and for the first time openly allowed private entrepreneurs to join the communist party (Xinhua News Agency, November 18, 2002), originally the party for poor workers and farmers. It remains to be seen how far this dramatic change in party policy will affect the political dynamics in China, but what has already been seen is that private entrepreneurs have become an indispensable power in today's China. Their presence in politics will not only further enhance the business environment in China but will also contribute to the fundamental transformation of the economic and political ecology in China, a subject which deserves further research.

Appendix 1: Institutional Indices

Each of the five principal indices comprises several sub-indices. In total there are 25 sub-indices measuring 25 different dimensions of institutions. These sub-indices are computed using data from several sources. To get a single sub-index, the authors first give a score to each province according to some objective measures, such as the ratio of budgetary expenses to provincial GDP, the ratio of the non-state sector to gross industrial output, and the ratio of lawyers to the provincial population. These measures are obtained from statistical yearbooks or survey data.²⁵ These scores are then normalized to a value between 0 and 10 proportionately, with larger values indicating better market-supporting institutions. Indicators beyond the base year (1999) are relaxed from the “0-10” restriction so as to better reflect the continued advance of marketization over time. Thus, these sub-indices essentially measure 25 fine aspects of each provincial institutional environment relative to other provinces. The five principal indices are weighted averages of sub-indices for each of the five categories. The Principle Components Analysis approach is adopted to assign component weights in order to avoid any subjective bias.

²⁵The data in the NERI Index project mainly come from the statistical yearbooks of the National Statistics Bureau, which contain statistical information about prices and the administration of industry and commerce, the courts, consumers’ associations, as well as the government’s statistical information from banks’ surveys and the entrepreneur survey system, and survey information about rural households from the National Statistics Bureau.

Table 1: Descriptive Statistics of Variables (N = 3258)

Variables	Observations	Mean	Standard Deviation	Min	Max
Owner's attributes					
PC member	3258	0.17	0.38	0	1
CPPCC member	3258	0.35	0.48	0	1
Age	3221	43.9	8.1	22	76
Education (years of schooling)	3258	13.00	3.07	0	19
Years of management experience	3239	10.3	6.0	0	35
Rural origin	3258	0.65	0.48	0	1
Party Member	3225	0.30	0.46	0	1
Former public firm manager	3258	0.23	0.42	0	1
Firm's attributes					
Firm age	3158	6.0	4.3	0	28
Employment (persons)	3207	169.38	316.98	1	4000
Employment (natural log)	3207	4.23	1.33	0	8.29
Institutional indices					
Product Market	3248	7.88	1.70	0	10
Credit Market	3248	5.93	2.02	0.35	7.94
Over-regulation	3248	7.43	2.39	0	10
Informal tax burden	3248	5.43	1.97	0	10
Legal environment	3248	3.67	3.25	0.11	11.81

Table 2: Probability of Political Participation of Private Entrepreneurs Conditional on Each of the independent variables (N=3258)

Independent variables	Probability of participation (PC/CPPCC)	
	Each independent variable less than or equal to median	Each independent variable above median
<i>Human capital</i>		
Age	0.40	0.53
Education	0.46	0.47
Years of management experience	0.39	0.55
Rural origin	0.42	0.49
<i>Political capital</i>		
Party member	0.46	0.55
Former public firm manager	0.45	0.54
Firm age	0.39	0.54
Employment	0.35	0.58
<i>Institutional indices</i>		
Product Market	0.53	0.43
Credit Market	0.56	0.43
Over-regulation	0.58	0.43
Informal tax burden	0.44	0.52
Legal environment	0.50	0.44

a. The numbers in the table are the probabilities of an entrepreneur being a member of either the People’s Congress or the Chinese People's Political Consultative Committee.
b. If the independent variable is a dummy variable, we divide it into two groups according to its two values, i.e., zero and one.

Table 3 : Multinomial Logit Regressions Examining the Determinants of Political Participation of Private Entrepreneurs

	Dependent variable					
	(1)		(2)		(3)	
	P C	CPPCC	P C	CPPCC	P C	CPPCC
Human capital						
Age	0.031*** (4.56)	0.022*** (3.92)	0.025*** (4.24)	0.021*** (3.61)	0.030*** (3.95)	0.023*** (3.72)
Education	0.048*** (2.69)	0.080*** (5.30)	0.035* (1.92)	0.080*** (5.24)	0.000 (0.01)	0.062*** (3.87)
Experience	0.069*** (7.71)	0.073*** (9.61)	0.072*** (7.98)	0.073*** (9.59)	0.050*** (4.93)	0.044*** (5.11)
Rural origin	0.570*** (6.42)	0.152 (1.64)	0.524*** (4.27)	0.139 (1.50)	0.557*** (4.31)	0.184* (1.89)
Political capital						
Party Member			0.620*** (3.35)	0.128 (0.71)	0.706*** (3.46)	0.053 (0.27)
Former public firm manager			0.574*** (4.92)	0.018 (0.17)	0.506*** (4.07)	0.042 (0.38)
Employment (log)					0.581*** (12.38)	0.326*** (8.73)
Firm age					0.034** (2.44)	0.071*** (6.16)
Other control variables						
Sector indicators	Yes		Yes		Yes	
Pseudo R-Sqr	0.06		0.06		0.10	
LR Chi-sqr-statistics	357.39***		394.02***		617.95***	
Obs	3209		3176		3049	

a. Numbers in parentheses are z-ratios.
b. Significance levels of 0.1, 0.05 and 0.01 are noted by *, **, and ***.

Table 4 : Multinomial Logit Regressions Examining the Determinants of Political Participation of Private Entrepreneurs

	Dependent variable					
	(4)		(5)		(6)	
	P C	CPPCC	P C	CPPCC	P C	CPPCC
Human capital						
Age	0.030*** (4.02)	0.023*** (3.78)	0.031*** (4.09)	0.024*** (3.89)	0.031*** (4.10)	0.024*** (3.89)
Education	-0.001 (-0.03)	0.062*** (3.85)	-0.005 (-0.25)	0.055*** (3.40)	-0.006 (-0.28)	0.055*** (3.35)
Experience	0.049*** (4.88)	0.045*** (5.18)	0.049*** (4.83)	0.045*** (5.10)	0.049*** (4.82)	0.045*** (5.09)
Rural origin	0.545*** (4.22)	0.182* (1.86)	0.561*** (4.32)	0.204** (2.06)	0.573*** (4.41)	0.215** (2.17)
Political capital						
Party Member	0.725*** (3.54)	0.076 (0.38)	0.737*** (3.59)	0.101 (0.51)	0.744*** (3.62)	0.110 (0.55)
Former public firm manager	0.513*** (4.12)	0.040 (0.36)	0.543*** (4.34)	0.080 (0.70)	0.542*** (4.33)	0.081 (0.71)
Employment (log)	0.586*** (12.43)	0.329*** (8.75)	0.575*** (12.15)	0.308*** (8.07)	0.570*** (12.03)	0.303*** (7.95)
Firm age	0.034** (2.45)	0.069*** (6.01)	0.033** (2.37)	0.068*** (5.87)	0.034** (2.42)	0.069*** (5.92)
Institutional indices						
Product Market	-0.028 (-0.85)	-0.073*** (-2.91)			0.055 (1.49)	0.045 (1.56)
Credit Market			-0.133*** (-4.69)	-0.198*** (-8.89)	-0.155*** (-4.86)	-0.216*** (-8.57)
Other control variables						
Sector indicators	Yes		Yes		Yes	
Pseudo R-Sqr	0.10		0.12		0.12	
LR Chi-sqr-statistics	626.84***		701.12***		704.55***	
Obs	3039		3039		3039	

a. Numbers in parentheses are z-ratios.
b. Significance levels of 0.1, 0.05 and 0.01 are noted by *, **, and ***.

Table 5 : Multinomial Logit Regressions Examining the Determinants of Political Participation of Private Entrepreneurs

	Dependent variable					
	(7)		(8)		(9)	
	PC	CPPCC	PC	CPPCC	PC	CPPCC
Human capital						
Age	0.030*** (4.03)	0.023*** (3.72)	0.030*** (4.00)	0.023*** (3.76)	0.031*** (4.12)	0.024*** (3.97)
Education	0.001 (0.06)	0.067*** (4.08)	-0.001 (-0.04)	0.062*** (3.86)	0.009 (0.44)	0.073*** (4.45)
Experience	0.050*** (4.91)	0.047*** (5.32)	0.049*** (4.87)	0.045*** (5.15)	0.050*** (4.88)	0.045*** (5.11)
Rural origin	0.523*** (4.03)	0.140 (1.41)	0.547*** (4.23)	0.199** (2.04)	0.459*** (3.51)	0.101 (1.01)
Political capital						
Party Member	0.704*** (3.43)	0.022 (0.11)	0.734*** (3.58)	0.087 (0.44)	0.701*** (3.40)	0.054 (0.27)
Former public firm manager	0.515*** (4.13)	0.025 (0.22)	0.513*** (4.12)	0.036 (0.32)	0.450*** (3.99)	0.019 (0.17)
Employment (log)	0.575*** (12.23)	0.310*** (8.17)	0.586*** (12.44)	0.326*** (8.70)	0.584*** (12.35)	0.324*** (8.61)
Firm age	0.033** (2.40)	0.067*** (5.73)	0.035** (2.39)	0.071*** (6.16)	0.033** (2.39)	0.069*** (5.96)
Institutional indices						
Credit Market						
Over-regulation	-0.067*** (-2.84)	-0.146*** (-7.77)				
Informal tax burden			-0.024 (-0.88)	-0.008 (-0.35)		
Legal environment					-0.084*** (-4.24)	-0.083*** (-7.65)
Other control variables						
Sector indicators	Yes	Yes	Yes	Yes	Yes	Yes
Pseudo R-Sqr	0.11	0.10	0.10	0.11	0.12	0.12
LR Chi-sqr-statistics	679.54***	619.26***	619.26***	658.84***	747.46***	747.46***
Obs	3039	3039	3039	3039	3039	3039

a. Numbers in parentheses are z-ratios.
b. Significance levels of 0.1, 0.05 and 0.01 are noted by *, **, and ***.

Table A1: Definitions of Firm-Level Variables

Variable name	Definition
Owner's attributes	
PC member	1 if a member of the PC at any level, 0 otherwise
CPPCC member	1 if a member of the CPPCC at any level, 0 otherwise
Education	Years of schooling
Rural origin	1 if born in rural regions
Party Member	1 if a Party Member, 0 otherwise
Former public firm manager	1 if formerly served as manager in SOE or TVE
Firm's attributes	
Firm age	How many years ago the firm has come into existence
Employment (persons)	Number of persons employed. +1 for whole-year employment; + 0.5 * for employment for less than one year but more than 6 months; + 0.25 * for employment for less than 6 months.
Other control variables	
Sector indicators	14 industry sector indicators

Table A2: Institutional Indices

- 1.Relationship between government and market
 - 1a. proportion of economic resources allocated through market
 - 1b. tax and charge burden on farmers
 - 1c. government’s excessive administrative intervention in enterprises
 - 1d. enterprises’ non-tax burden
 - 1e. excessive size of government (overstaffing)

 - 2.Development of the non-state sector
 - 2a. proportion of the non-state sector in gross industrial output
 - 2b. proportion of the non-state sector in national investment in fixed assets
 - 2c. proportion of the non-state sector in number of employed persons

 - 3. Development of the goods market
 - 3a. percentage of products with market-regulated prices
 - 3b. degree of local protectionism

 - 4. Development of the factor market
 - 4a. development of the financial market
 - 4b. degree of absorption of foreign investment
 - 4c. liquidity of the labor force
 - 4d. transactions of local technology market weighted by number of technicians

 - 5. Development of market intermediaries and the legal environment
 - 5a. development of market intermediaries (proportion of lawyers and accountants in the population)
 - 5b. protection of property rights
 - 5b1. numbers of economic cases and consumer complaints for every 100 million yuan of GDP
 - 5b2. number of closed cases relative to number of cases handled – economic case
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